LESA
SROUFE&CO INC.
VALUE ADVISORS

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Second Quarter Update and Outlook

The broad market averages gained steam overall in the second quarter, despite a ferocious dip in the month of May. Our holdings recovered too, but not enough to compensate for our flat performance in April when the broad market indexes were sharply higher. In the second quarter of 2019, international markets and small cap stocks continued to lag the large capitalization stocks, as did value versus growth, the same theme that has prevailed for several years. Most new investment flows are focused on these better performing areas, reinforcing their past performance. They call that momentum investing. We are focused on out of favor sectors and companies, which we believe offer strong future investment opportunities, even though they haven't done much for us lately. One of the strongest asset classes in the quarter was gold, which pretty much got all of its upside performance in the month of June. The bounce coincided with talk of future Central Bank interest rate cuts, both in the U.S. and in Europe, and a slowdown in economic growth in the U.S. The Fed is in the unenviable position of never having really unwound its extreme monetary stimulus policy a decade after the financial crisis.

During the quarter, we purchased one stock and sold two in the model portfolio. We purchased Tutor Perini Corp., a U.S. focused commercial construction company. The company specializes in public works construction and replacement infrastructure, including highways, bridges, rail, subways and water. The stock's depressed price reflects the current elevated amount of unbilled revenue: completed projects for which it has not yet been fully paid. Progress on its collections, mostly from government-related projects, would improve investor attitudes towards the stock. Nevertheless, the business outlook remains promising for the company which is experiencing a record backlog and record project bidding opportunities, along with the uptick in U.S. infrastructure projects.

We sold First Energy, an Ohio based electric utility, because the stock reached our price objective. The electric utility sector has benefitted from near record low interest rates that have resulted in strong investor interest in dividend paying utilities. In addition, First Energy has completed an overhaul to its business that has made it more profitable. We believe the sector's extended valuation makes it vulnerable to rising interest rate cycles, currently not expected by most investors. We also sold Teva Pharmaceuticals. Teva is best known for its multiple sclerosis drug Copaxine and its broad generics business. Teva, like other opioid manufacturers is being sued by several U.S. states for improper marketing. In a disappointing surprise, Teva chose to settle rather than fight the first of what will likely be many lawsuits. U.S. government generated lawsuits have usually proved to be costly and drawn out for corporations.

U.S. economic growth is slowing. Earnings estimates for corporations have been cut to reflect rising costs and moderating sales growth. The U.S. large company index averages are trading at all-time highs, yet U.S. government bond yields are acting like the U.S. is already in an economic recession. This disconnect likely lies in the promise of future interest rate cuts and an end to the cost-raising tariff wars, both of which are not assured. Growth stocks have continued their outperformance over value in the first half of 2019, extending a trend that began in 2010. We are excited about owning companies that have promising long term prospects whose recent valuations and stock performance have not kept up with the high flyers that have dominated the market. These include many commodity, industrial and financial related companies and a broad range of international stocks. Our significant invested cash reserves in the LSC Opportunistic model reflect the current high valuations assigned to much of the U.S. markets.

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